GRADE 11 – BUSINESS STUDIES

Chapter 7 – Formation of a Company

Multiple Choice Questions

1. Minimum number of members to form a private company is
(a) 2
(b) 3
(c) 5
(d) 7
► (a) 2

2. Minimum number of members to form a public company is
(a) 5
(b) 7
(c) 12
(d) 21
► (b) 7

3. Application of approval of name of a company is to be made to
(a) SEBI
(b) Registrar of Companies
(c) Government of India
(d) Government of the state in which company is to be registered.
► (b) Registrar of Companies

4. A proposed name of Company is undesirable if
(a) It is identical with the name of an existing company
(b) It resembles closely with the name of an existing company.

(c) it is an emblem of Government
(d) in case of any of the above.

► (d) in case of any of the above.

5. A prospectus is issued by
(a) A private company
(b) A public company seeking investment from public.
(c) A public enterprise
(d) A public company

► (d) A public company
6. Stages in the formation of a public company are in the following manner
(a) Promotion, Commencement of business, Incorporation, Capital Subscription
(b) Incorporation, Capital Subscription, Commencement of business, promotion
(c) Promotion, Incorporation, Capital Subscription, Commencement of Business
(d) Capital Subscription, Promotion, Incorporation, Commencement of Business
► (c) Promotion, Incorporation, Capital Subscription, Commencement of Business

7. Preliminary Contracts are signed
(a) before the incorporation
(b) after incorporation but before capital subscription
(c) after incorporation but before commencement of business
(d) after commencement of business
► (a) before the incorporation

8. Preliminary Contracts are
(a) binding the company
(b) binding on the company, if ratified after incorporation
(c) binding on the company after the incorporation
(d) not binding on the company
► (d) not binding on the company

True/False Answer Questions

9.It is necessary to get every company incorporated, whether private or public.
► True

10.Statement in lieu of prospectus can be filed by a public companygoing for a public issue.
► False

11.A private company can commence business after incorporation.
► True

12.Expert who help promoters in the promotion of a company are alsocalled promoters.
► False

13.A company can ratify preliminary contracts after incorporation.
► False

14. If a company is registered on the basis of fictitious names, itsincorporation is invalid.

▶ False

15. 'Articles of association' is the main document of a company.
▶ False

16. Every company must file Articles of Association.
▶ False

17. A provisional contract is signed by promoters before the incorporation of the company.
▶ False

18. If a company suffers heavy losses and its assets are not enough topay off its liabilities, the balance can be recovered from the private assets of its members.
▶ False

Short Answer Questions

19.Name the stages in the formation of a company.

Answer

The different stages in the formation of company are:
- Promotion
- Incorporation
- Subscription of capital
- Commencement of Business

20. List the documents required for the incorporation of a company.

Answer

The documents which are required for the incorporation of a company are:

→ The Memorandum of Association duly stamped, signed and witnessed.
→ The Articles of Association duly stamped and witnessed.
→ Written approval of the proposed directors to function as directors and an undertaking to buy the qualification shares.
→ An agreement naming the proposed managing director or a manager or a full-time director, if any.
→ A copy of the letter obtained from the registrar concerned approving the company name proposed.
→ A legal confirmation by the law stating the submission of all documents and requirements for registration.
→ The exact address of the registered office.
→ Documentary evidence of payment of the registration fee.

21. What is a prospectus? Is it necessary for every company to file aprospectus?

Answer

A prospectus is 'any document described or issued as a prospectus including any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares or debentures of, a body corporate'. In other words, it is an invitation to the public to apply for

shares or debentures of the company or to make deposits in the company.
A prospectus is only required by a Company which wants to invite public to buy its shares or to invest in it. Prospectus is not required when the company opts for private investment.

22. Explain the term 'Minimum Subscription'.

Answer

When shares are issued to the general public, the minimum amount that must be subscribed by the public so that the company can allot shares to the applicants is termed 'minimum subscription'. The limit of minimum subscription is 90 per cent of the size of the issue. If the 'Minimum Subscription' is not achieved then allotment cannot be made and the Company will have to refund the application money to prospective subscribers.

23. Briefly explain the term 'Return of Allotment'.

Answer

Return of Allotment is a statement submitted to the Registrar which contains the names and addresses of shareholders and the number of shares allotted to each shareholder. It is signed by a director or secretary is filed with the Registrar of Companies within 30 days of allotment. Return of allotment shows that the company has received the minimum subscription.

24. At which stage in the formation of a company does it interact

withSEBI?

Answer

A company interacts with SEBI (Securities and Exchange Board of India) in the third stage of formation that is, in the stage of capital subscription because company is required to raise its funds from the general public through the medium of issue of shares and debentures. To do so, the company is required to follow the rules and guidelines prescribed by SEBI in order to protect the investors' interests. Thus, it is necessary for the company to get SEBI's approval before proceeding with capital subscription.

25. Distinguish between 'preliminary contracts' and 'provisionalcontracts'.

Answer

The contracts are signed by the promoters of a company with the third parties during the promotion of the company are called preliminary contracts or pre-incorporation contracts. These are not legally binding on the company. Therefore, these contracts are not enforceable unless fresh contracts are created on the same terms and conditions after the company comes into existence.
The contracts which are signed after incorporation but before the commencement of business are called provisional contracts. These become enforceable only after the company gets the Certificate of Commencement of Business.

Long Answer Questions

26.What is meant by the term 'promotion'? Discuss the legal position ofpromoters with respect to a company promoted by them.

Answer

Promotion is the first stage in the formation of a company. It involves conceiving a business opportunity and taking an initiative to form a company so that practical shape can be given to exploiting the available business opportunity. Thus, it begins with somebody having discovered a potential business opportunity. Any person or a group of persons or even a company may have discovered an opportunity. If such a person or a group of persons or a company proceeds to form a company, then, they are said to be the promoters of the company.
The legal position of promoters with respect to a company promoted by them are:
→ The promoters are neither the trustees nor the agents of the company that they are forming. This is because the company does not exist as a legal entity before its incorporation.
→ They cannot make any secret profits by making deals on behalf of the company.
→ They are legally liable for any untrue statement filed in the prospectus of the company.
→ The promoters cannot claim the expenses incurred by them during the promotion of the company.
→ The company may or may not indemnify the promoters for the payments made before its incorporation. The company may choose to allot shares to them in order to compensate for their services.

27. Explain the steps taken by promoters in the promotion of a company.

Answer

Promoter is a person who undertakes to form a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose. The steps taken by promoters in the promotion of a company are:

→ Identification of business opportunity: The first and foremost activity of a promoter is to identify a business opportunity. The opportunity may be in respect of producing a new product or service or making some product available through a different channel or any other opportunity having an investment potential.

→ Feasibility studies: All the identified business opportunities may not be feasible or profitable as real projects. The promoters, therefore, undertake detailed feasibility studies to investigate all aspects of the business they intend to start with the help of charted accountants, engineers, accountant, etc.. Various types of feasibility includes:

• Technical feasibility: Sometimes an idea may be good but technically not possible to execute. It may be so because the required raw material or technology is not easily available. Therefore, the technical feasibility of the idea has to be considered before proceeding further.

• Financial feasibility:Every business activity requires funds. The promoters have to estimate the

fund requirements for the identified business opportunity. If the project cannot be financed within the fund available then idea may have to be dropped.

• Economic feasibility: Sometimes it so happens that a project is technically viable and financially feasible but the chance of it being profitable is very little. So, the idea will have to given up.

→ Name approval: The promoters have to select a name for it and submit, an application to the registrar of companies of the state in which the registered office of the company is to be situated, for its approval. The proposed name may be approved if it is not considered undesirable. In such cases the proposed name is not accepted but some alternate name may be approved. Therefore, three names, in order of their priority are given in the application to the Registrar of Companies.

→ Fixing up Signatories to the Memorandum of Association: Promoters have to decide about the
members who will be signing the Memorandum of Association of the proposed company. Generally, who sign the MoA become the first directors of the company.

→ Appointment of professionals: Certain professionals such as mercantile bankers, auditors etc., are appointed by the promoters to assist them in the preparation of necessary documents which are required to be with the Registrar of Companies. The details of the number of shares allotted to each shareholder, along with his or her addresses for correspondence, are submitted to the registrar.

→ Preparation of necessary documents: The promoter takes up steps to prepare certain legal
documents includes Memorandum of Association, Articles of Association and Consent of Directors, which have to be submitted under the law, to the Registrar of the Companies for getting the company registered.

28. What is 'Memorandum of Association'? Briefly explain its clauses.

Answer

Memorandum of Association is the most important document as it defines the objectives of the
company. No company can legally undertake activities that are not contained in its Memorandum of Association. The Memorandum of Association contains different clauses, which are:

→ The name clause: This clause contains the name of the company with which the company will be known, which has already been approved by the Registrar of Companies.

→ Registered office clause: This clause contains the name of the state, in which the registered office of the company is proposed to be situated.

→ Objects clause: It defines the purpose for which the company is formed. A company is not legally entitled to undertake an activity, which is beyond the objects stated in this clause. It can be divided into two types:

• The main objects: The main objects for which the company is formed are listed in this sub-clause.
• Other objects: Objects not included in the main objects could be stated in this sub-clause.

→ Liability clause: This clause limits the liability of the members to the amount unpaid on the shares owned by them.

→ Capital clause: This clause specifies the maximum capital which the company will be authorised to raise through the issue of shares.

→ Association clause: In this clause, the signatories to the Memorandum of Association state their intention to be associated with the company and also give their consent to purchase qualification shares.

29. Distinguish between 'Memorandum of Association' and 'Articles ofAssociation.'

Answer

Basis of difference	Memorandum of Association (MoA)	Articles of Association (AoA)
Objective	The MoA defines the character of a company and the scope of its activities.	The AoA defines the rules and regulation of the company.
Position	It is the main document of a company which is subordinate to the Companies Act.	It is the subsidiary document of a company which is subordinate to both MoA and the Companies Act.
Relationship	The MoA establishes the relation between the company and outsiders.	The AoA defines the relation of the company with its members.
Alteration	Altering the MoA requires the approval of a statutory authority.	The AOA can be easily altered by passing a resolution.

Ratification	Acts beyond MoA cannot be ratified.	Acts beyond the AoA can be ratified by the members if they do not violate the MoA.
Necessity	It is a necessary document.	It is a secondary document.

30. What is the effect of conclusiveness of the 'Certificates ofIncorporation' and 'Commencement of Business'?

Answer

Effect of Certificates of Incorporation:
→ A company becomes a legal entity with perpetual succession on the date printed on the Certificate of Incorporation. After conclusiveness of the certificate of incorporation, the company becomes entitled to enter into valid contracts.

→ The Certificate of Incorporation is a conclusive evidence of the regularity of the incorporation and legal existence of a company even if there is any flaw in its registration process.

→ A company can immediately commence its business once its certificate of incorporation is issued. Thus, the certificate of incorporation is conclusive evidence of the existence of a company. As a result, the birth of the company cannot be questioned if it has the certificate of incorporation.

Effect of Certificate of Commencement of Business

→ The certificate of commencement of business is issued by the registrar of companies when all the documents submitted by the company are found satisfactory.

→ The commencement of business certificate acts as definite proof for the company that it has the legal right to do business.

→ The formation of a public company is completed once it is granted the certificate of commencement of business. Thus, the business activities of the company cannot be questioned as it is legally allowed to start its business after getting the certificate.

31. Is it necessary for a public company to get its share listed on a stock exchange? What happens if a public company going for a public issue fails to apply for a stock exchange for permission to deal in its securitiesor fails to get such permission?

Answer

Yes, it is mandatory for every public company to be listed on a stock exchange. The public company is required to send an application to at least one stock exchange to get registered. Once it is listed, the company is allowed to offer its shares in order to become public. However, initially the company may offer only a small percentage of its shares to the public.

If a public company going for a public issue fails to apply to a stock exchange for permission to deal in its securities or fails to get such permission before the expiry of ten weeks from the date of closure of subscription list, the allotment of shares done by the company shall become void and all money received from the applicants will have to be returned to them within eight days